

ECONOMIC DEVELOPMENT PLAN

FOR THE

MUNICIPALITY OF DONJI LAPAC

Prepared for:

Mercy Corps

and the

United States Agency for International Development



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1. Introduction

FLAG International LLC (FI) is currently implementing an economic development program in Donji Lapac under a Mercy Corps subgrant agreement as a component of the USAID “Increased, Sustained Returns in Economically and Socially Revitalized War-Affected Areas” activity. The goal of the FI program is to generate economic activity and employment opportunities which will revitalize the area and support the process of refugee return and reintegration.

FI has developed this **Economic Development Plan for the Municipality of Donji Lapac** with the help of the Mayor, other officials, and a number of local residents and organizations. Among these are several non-government organizations: Stope Nade, Dalmatinki Odbor Solidarnosti, the Donji Lapac Women's Association, and the Lika Agricultural Cooperative. A full list of the organizations whose views we sought is given in Appendix C.

The premise of the plan is that economic development, as represented by increasing local employment, incomes, and tax revenues is a necessary condition for re-vitalization of the life of the area. Based upon that premise, this plan describes some **strategic objectives** and then goes on to propose a number of specific initiatives, the total of which comprise the essential elements of an economic development strategy for Donji Lapac.

The plan **incorporates the municipality's goals** of transparency, publicity, fairness, safety of property rights and efficiency. At the same time, it recognizes that municipality officials themselves have limited authority and few resources. A common problem in Croatia is that entrepreneurs look towards local and State governments for solutions to economic problems. This approach has frequently failed in Croatia due to inadequate resources of these institutions. In the end, improvements in the economic situation of Croatia will depend on market-oriented solutions and will be based on the economic potential of each solution to generate profit. FI will push the municipality to dedicate what resources it has to these ends.

FI will work with local residents, officials, local and international organizations, donor institutions, and other partners to combine their resources for the economic development of the area. But while encouraging the combination of resources, FI will especially seek to enlist **local entrepreneurs and agricultural producers** to step forward and work for their own economic benefit and that of the municipality. The plan encourages officials and residents jointly to focus efforts on key industries: agricultural production and processing, wood processing, construction and cement, and tourism..

Successful execution of this economic development plan must be attempted despite the **significant destruction** of houses and other buildings which presents the most severe challenge to the redevelopment of the economy in Donji Lapac. This study addresses only peripherally the necessity for major reconstruction of the basic infrastructure assets of the municipality. Although the need for rebuilding in the municipality is great, this plan focuses exclusively on steps needed for SME and agricultural income development and job creation.

FI will develop and work with **counterpart organizations**, primarily the Development Council, the local Tourist Board and other community-based organizations, to assist in implementing the plan. FI will foster the support of all members of the community to create a better economic environment, revitalize the community and increase employment opportunities in Donji Lapac.

2. Executive Summary

This plan includes an analysis of existing conditions, particularly in comparison to the pre-conflict situation, and recommendations to promote economic development and employment to facilitate the process of return and reintegration. The recommendations included in this plan are focused on increasing the level of economic activity in the local community, protecting the area's unique heritage, and creating an economic “engine of development” for Eastern Lika.

FI will work directly with the municipality and its residents to implement this plan. The plan, in itself, will not create value for local residents unless its recommendations are adopted by the community and acted upon with enthusiasm. It is up to the municipality to support these proposals, so that other market participants will see its interest in real, demonstrable terms of time and other resource investment and be encouraged to contribute their own efforts in the knowledge that municipal support will be forthcoming for their mutual benefits.

The plan consists of a series of recommendations for technical assistance and economic development programs in Donji Lapac. These recommendations are based on assistance models that have proven successful in other parts of Croatia. These recommendations include, in the short term, promoting and providing technical assistance to the Lika Agricultural Cooperative in Donji Lapac as well as other village-level agricultural organizations in the municipality, establishing a strong relationship with local partners such as the Croatian Extension Service, Livestock Selection Service, and County Department of Agriculture, as well as coordinating technical and donor assistance for members of other specialized agricultural cooperatives and associations.

Short-term recommendations are also proposed to strengthen SMEs to facilitate job creation, including business plan writing in order to locate financing for unutilized manufacturing facilities. Recommendations are also made to evaluate the possibility of re-starting wood processing, cement production and tourism through the development of feasibility studies, market research, and examining the possibility of reconnecting these enterprises to former markets and suppliers in Southeast Europe.

In the long term, FI recommends determining the most profitable agricultural products in the area and providing technical assistance to organize and register new agricultural cooperatives that will provide value-added services and processing for their members. Agricultural cooperatives should be modeled after US or EU cooperatives in their bylaws, services, and ownership structure. FI also recommends an intensive search for bank or donor-supported start-up capital to these agricultural cooperatives through a program to develop value-added services. Farmers must also be encouraged to register as taxpayers and to adopt modern farm record keeping systems.

The plan outlines a long-term process and improvements in the economic situation will occur incrementally and not overnight. Implementation will depend on market and local resident reaction and must have the flexibility to allow for tactical decisions to be taken along the way. Immediately below, in summarized format, is a proposed set of tasks which are further elaborated upon in the balance of the plan:

Task Summary (in priority order):

- a Business Support Center must be developed to focus intensively on SME and agricultural development exclusively in Donji Lapac. FI will create and sustain the center and transfer it to the local authorities after the expiry of its mandate in late 2003.
- FI will organize a donor forum in the Spring 2002 to actively solicit new donor funding and interest in reconstruction efforts for the municipality. The conference, which will address the needs of 4-5 municipalities in the area, will be held in Plitvice and be titled "Infrastructure and Economic Development Forum for Eastern Lika."
- a local Development Council must be established to serve as an administrative center for marketing and promotion of the municipality to potential donors and investors, and to actively pursue contacts with financing institutions to increase investor awareness. FI will assist in establishing the Council and in coordinating its efforts to strengthen economic development in the municipality and add transparency to the decision-making process.
- a cheese production facility is a logical step which will allow farmers to receive added value for their milk production, and the concept is correctly being promoted by the municipality. However, there is not enough raw milk produced in the area to justify the investment and operating expenses of such a facility. FI will provide technical assistance to local farmers to increase milk production and encourage immediate efforts to increase the number of dairy cows from 300 to 550, which is roughly the minimum number necessary to profitably operate a cheese production facility in the area.
- a Tourist Board must be formed in accordance with national laws and regulations in order to attract visitors and to engage in aggressive marketing efforts to increase tourism income. FI will assist the municipality in forming and developing the Tourist Board as well as a pilot project to develop accommodation and other services, in partnership with the Ministry of Tourism and the Croatian Tourist Board.
- FI and the municipality will search for funding and engage in other efforts to increase the touristic residential capacity and exposure of Donji Lapac so that "paying customers" (tourists) can stay for longer periods to generate income and increase interest in the area.
- the municipality must resolve ownership issues related to the wood processing facility, former cooperative properties and the abandoned buildings and hotels in the town. FI will assist in determining what can be salvaged from the destruction of the war, and will recommend disposal of the remainder immediately. The municipality and government must immediately unload non-performing assets. This process should begin with the Visočica cement facility.
- due to the ecologic purity of the area and a market for organic production, immediate efforts must be made to procure organic certification for basic agricultural production as well as to secure EU certificates pertaining to quality and source of local production. FI will work with farmers and provide technical assistance to develop a strategy for moving toward completion of the certification process.
- FI will work with local agricultural cooperatives, the Women's Association and other producers to produce a line of branded agricultural products (Lika cheese, basa cheese, dried fruits, etc.) to market outside the municipality, while simultaneously searching for a major buyer to stimulate production and generate income for local residents. One person at the municipality level will be put in charge of this effort and package it to attract government, bank or donor support.

3. Assessment of Possibilities (Vision)

Donji Lapac is the most remote area in Croatia and has one of the lowest population densities in Central Europe. The municipality is served by poor roads which are often closed in the winter. It has extensive water and electricity problems as well as severely damaged infrastructure. The war served to cut off the area from its natural markets in the Bihac region in Bosnia as well as to destroy the socialist economic regime which subsidized its loss-generating industrial production. In addition, the Croatian government has reduced the municipality's level of parliamentary representation through a process of political gerrymandering which has administratively separated it from Donji Srb and other ethnic Croatian Serb areas in the Eastern Lika region.

Considering that the area also has one of the highest proportions of destroyed houses and looted buildings in Croatia, there is little about the area's starting point on the road to economic development that could be termed positive. With a lack of western-trained management and a population just beginning to return from their exile in the Republika Srpska or Yugoslavia, there is little to support an analysis that the area can become self-sustaining without significant government or donor support.

However, the municipal leaders and residents are determined that economic development take place so that the population can support itself. In light of this, the disadvantages the municipality labors under might be overcome with the proper marketing and development of ideas. With good management, local resident support and effective coordination of local and international efforts, steps can be taken to develop the economic potential of the area.

The municipality's view of its development over the next 3-5 years, and the vision this development plan attempts to support include:

- a municipality where farmers, benefit from value-added processing of their production through their shared interest and ownership in cooperatives, for example milk into cheese, wool into cloth.
- a municipality which is known for high-quality agro-tourism and where rural farms, combined with the spectacular beauty of the surrounding geography, create synergies which allow for the generation of sustainable touristic income
- a municipality where SME's are fostered in an environment which supports their growth and development, and where a Business Support Center provides businesses with valuable consulting, business planning and other services.
- a municipality where a local Development Council, comprised of members representing the entire community, assists in coordinating funding of economic development efforts.
- a municipality which, due to its remoteness, ecologic purity, abundant clean water and lack of intensive agriculture and high-input industrial production, is devoted to the highest degree possible to the production of high-quality organic agricultural production.

To realize this vision, FI recommends the following actions designed to be carried out with a high degree of municipal support and community participation. They are presented in two categories: economic development recommendations (with subsections of SME development, wood processing and construction industry, and tourism development) and agricultural development recommendations (with subsections of general agricultural development, cheese production and organic production).

4. Economic Development Recommendations

A. General SME Development:

FI's goal is to re-vitalize the local economy, specifically by increasing economic turnover and employment. The economic entities that will be used to facilitate this are private sector SMEs and agricultural cooperatives. FI will use technical assistance, managerial education and mobilization of funding to facilitate this goal and to create employment opportunities in the area. Without start-up capital, SME activity is not expected to create many jobs or to provide an income above the Croatian minimum wage in the short-term. Recent efforts from various donor organizations, as well as new credit lines from the Croatian government and banks, can provide an opportunity to improve the situation and to create jobs in the municipality, if properly focused.

A number of SME's and manufacturing facilities existed prior to the war, but most were socialistic, non-competitive enterprises which no longer function. These enterprises cannot be expected to generate employment or to return to production. Most of these enterprises, if not all of them, will require more resources to reactivate than an equivalent greenfield investment elsewhere in the area. With the exception of the Visočica cement production facility and potentially the Plješevica wood processing facility, FI recommends that the former large state-owned industrial facilities not be considered for reactivation.

FI will target individual SME's and entrepreneurs interested in improving their economic situation with clear and well defined technical assistance. Technical assistance is designed for SMEs that have demonstrated the capacity to create jobs. These models have proven successful in other parts of Croatia and will be used as the basis for assistance in the Donji Lapac municipality.

Short-term Actions

Entrepreneurs and SMEs desiring technical assistance to expand their operations will be assisted (in the short term) in the following ways:

1. FI will establish and maintain a Business Support Center which will provide technical assistance in management, strategic planning, marketing and market research, in collaboration with consultants and business support centers as needed. The Center will be used to establish a strong relationship between Donji Lapac SME managers and the Croatian Chamber of Commerce as well as applicable Croatian ministries and commercial banks, which have a number of financing and technical support programs for SMEs. FI will also provide technical assistance to SMEs in evaluating debt financing opportunities, feasibility studies and in preparing business plans.
2. FI will organize a donor forum to solicit new and innovative sources of funding and to generate interest in economic development efforts. The conference will be held in Plitvice, will include multiple municipalities in the area and be titled "Infrastructure and Economic Development Forum for Eastern Lika."
3. FI will provide technical assistance in tax compliance to the management of SMEs and assist in establishing accounting and bookkeeping systems based on international accounting standards. Based on FI's experience, local companies are not familiar with Croatian accounting and bookkeeping regulations and, if audited and inspected, are often penalized by tax authorities.

Long-term Actions:

FI's long-term technical assistance will concentrate on:

1. Through the Business Support Center, FI will actively search for partners, equity investors or sources of debt or donor financing to assist entrepreneurs and SME's in finding capital for expansion. For SME's with high potential for profitable operations, FI will work with company management and other parties, including providing local and foreign experts, to develop documentation to attract foreign investment.
2. FI will assist in the development of a municipal Development Council which will serve as a local body for advocating the municipality to potential donors and other parties. The Council will consist of community members and will assume the role of coordinating community activities in terms of economic development. FI will work with the Council to develop it as a sustainable organization comprised of local leaders and other residents who will have a voice about their revitalizing their community.
3. FI will form a strong relationship with banks in the area to provide a link between SME's and sources of debt financing. This will include providing due diligence and other services that increase the likelihood of debt funding for client SME's. FI will work with the Council to pursue contacts with financing institutions and investors.
4. FI will assist to the highest degree possible the Croatian Privatization Fund (CPF) and the municipality to resolve ownership issues related to the wood processing facility, former cooperative properties and other facilities in the area.
5. FI recommends the engagement a reputable surveying firm to draw up a land use study which would recommend areas for redevelopment, new development as well as set aside a portion of the local forest property for low impact use. This study will be used, if funded, to facilitate debt and other financing opportunities in the area.
6. FI will offer assistance to a few key industries which have a competitive advantage and offer the potential of sustained economic activity. These include cheese production, wood processing, the cement and construction industries and tourism

Wood Processing and Construction Industry Development

Wood Processing: In the years leading up to the recent war, Donji Lapac had an active wood processing industry based on a large sawmill which employed 360 workers in three shifts. The Plješevica facility consisted of a primary and secondary saw-mill, veneer production, drying facilities, steaming facilities, a maintenance department, a boiler room, a joinery, an administration building and a restaurant. Overall, wood processing and support employed almost 20% of the local workforce and represented a considerable portion of the overall economic output of the municipality.

Currently, this sawmill is in bankruptcy after a dubious privatization and extensive corporate fraud on the part of the new owners. Most of the assets of the facility, including the processing equipment, have been stolen and the facility is completely inactive. The facility's status is scheduled to be resolved late in the year 2002 by the county bankruptcy court. FI will work with the court to see if a solution can be found to reactivate the sawmill but, based on the almost complete lack of wood processing equipment in the facility due to theft, as well as extensive debts by the company to HBOR and other parties, FI does not anticipate that wood processing in the *existing facility* will be possible in the short term.

With 20,000 hectares of forest land and the existence of local, experienced managers from before the war, wood processing has considerable potential to create jobs and economic growth in the municipality. FI will conduct a market survey of the forestry and wood industries in the area to evaluate existing conditions and to provide accurate market information to potential operations in the region. Using experienced consultants, a detailed feasibility study can be prepared to locate an operator and to engage banks, the municipality and the Croatian forestry authorities in a project to revitalize the wood industry. Upon completion of such a project, this revitalization can provide significant employment opportunities in the area.

Construction and Cement: Due to the devastated state of the houses and local infrastructure in Donji Lapac, extensive reconstruction will be taking place in the area for the next 6-8 years. A large market of over USD 1 million in reconstruction and development per year exists in the area¹, including nearby western Bosnia, for a well-run local construction company to engage in reconstruction efforts. In addition, there is a large gravel pit near the center of town which before the war was used as a source of raw materials to produce cement. For these reasons, the construction and cement industries can offer significant potential to generate economic activity in the municipality over the long term.

Before the war, the Visočica cement company (originally founded as a communal company in 1978) built a facility near the town center for the production of concrete elements (blocks, curbstones, beams, etc.). The firm participated in the majority of pre-war regional construction works and had a production capacity of 60 cubic meters of concrete per hour using 170 workers. Today, the Croatian Privatization Fund (CPF) is the 100% owner of the destroyed facility and the major debt holder is the municipality itself, due to a decade's worth of unpaid communal and utility charges. The municipality has a plan to combine the facility with the newly-formed local communal company Komgrad LLC which has now assumed communal duties in the municipality. The intent is to create a municipally-owned construction and communal company which will be a strong player in the wider reconstruction market in the area.

While USAID policy and FI preference are to seek private sector solutions, the existence of the municipality as the major creditor means that it must be party to a resolution of the problem. The idea of conserving the firm through municipality ownership has merit on an interim basis while strategic investors are sought. When privatization is achieved, the municipality claims can be resolved and the company can begin normal operation as a private entity. Significant challenges exist in developing the potential of this concept, including large debts to the municipality, difficulty in procurement of permits for the gravel removal operation, and large working capital requirements. An effort must be made to develop these assets with an emphasis on preserving the beauty and sustainability of the natural resources in the area. In the long term, FI considers that the area has a number of competitive advantages in terms of the construction and cement industry and will assist to the degree possible to develop this as an engine of economic development.

¹ Estimated value of reconstruction efforts projected by the EU, ASB and UNHCR in eastern Lika and western Bosnia annually, from 2002-2005

Tourism Development:

Donji Lapac is a richly wooded area with incredible geological diversity and offers significant potential to the visiting tourist. Before the war the area attracted numerous visitors from western Europe, particularly due to its location near unspoiled major rivers and forest areas. Today, sharing the environmental and ecological richness of Donji Lapac with tourists can be a key element to retaining population in the area. Proper organization and marketing of what Donji Lapac offers will increase the number of tourists and thereby tourism income. Local residents can benefit from this by profiting from the leveraging of their farm assets into the creation of new income opportunities, which can be significant in relative terms considering the low level of income currently earned by most residents in this economically depressed area. Even the occasional touristic stay can improve to the quality of life of community members, particularly rural residents.

Tourism must be considered a strategic industry which will generate significant economic activity within 3-5 years. Although major impediments currently exist, including destroyed hotels and houses, acute lack of private accommodation and chronic infrastructure damage, Donji Lapac has the ability to substantially increase its revenues from tourism (albeit from zero) in the short term. As the residents of Donji Lapac continue to move away from subsistence agriculture and towards Croatia's towns and cities, tourism in the Donji Lapac area can play a vital role in preserving local traditions and preventing the departure of the population.

Studies by the Croatian tourism authorities² indicate that hunting, nature and agro-tourism will be important sectors in Croatia's tourism market over the next decade. Trends in Europe show increasing tourist spending on small local farms which offer quality home-grown food and an opportunity to view farm life in a rural and quiet setting (agro-tourism). These trends are confirmed by recent data from the Istra region of Croatia, which has recently formed an association of local farmers to coordinate agro-tourism activities and attract foreign tourists.

To help Donji Lapac move from zero visibility in tourism to increased visibility and increased tax and other revenues for the municipality:

- Donji Lapac should develop its tourism profile as a quality, medium-range "European" nature reserve destination for lower to middle-income travelers. To achieve this vision, the tourism infrastructure must be upgraded to the desired market, and the wealth of tourism products (hunting, nature tours, rafting) marketed to individual segments. While pursuing this strategy, Donji Lapac should focus in the near term on the Eastern European market, and lower-scale elements of West European hunting and agro-tourism segments.
- Address the lack of accommodation for visitors. This problem will begin to solve itself when a functioning Tourist Board begins to: a) develop interest on the part of tourists in visiting the area; b) increase interest on the part of residents in offering revenue-generating accommodation, and; c) awaken interest on the part of relevant local and national tourist authorities in promoting the area. Funds from the Croatian Tourist Ministry and the HTZ, as well as bank credits, can be used to improve tourist facilities. Programs by these and other institutions are already in place.

² Source: Master Tourist Plan for Croatia, Institute for Tourism, 2000

- The tourism potential of Donji Lapac should focus on creating synergies between agriculture producers, the clean environment and the relative isolation of the area, which in the tourist industry is marketed under the label "agro-tourism." Organic production and the local wildlife excess for hunting can also play an important role in this process.
- In the Plitvice area, which also suffered occupation and significant destruction during the war, reconstruction took place at a faster pace due to the tourism income potential of the area, which attracted increased donor and bank reconstruction funding. Tourism can also be used in Donji Lapac as a "lever" and thus secure additional funding for the area.

To achieve these objectives, FI recommends the municipality undertake several activities:

- 1) The municipality should form a Tourist Board (TZ) and register future activities with the applicable county and national tourist organizations
- 2) The municipality should develop the Park of Nature in the mountainous Plješevica area in the northern section of the municipality. The area offers incredible natural beauty to tourists, including Roman ruins and a waterfall arguably more impressive than Plitvice, one of the main tourist attractions of Croatia.
- 3) The municipality should solicit expressions of interest from local and national SME's who will develop facilities under concession to expand the present tourist offer
- 4) A local map, brochures, promotional materials and other marketing efforts should be developed, using funds provided by the Croatian National Tourist Board

FI will assist municipal authorities (who have significant experience in this area) as well as local entrepreneurs to achieve the above actions for tourism development. This will include creating an effective financial planning and budgeting plan for the Donji Lapac TZ which will be formed. This tourism development process will begin in Spring of 2002.

B. Agriculture

General Agricultural Development:

FI's goal is to encourage development of the agricultural economy. This will be realized using mainly two different kinds of participants in the local economy: agricultural associations and cooperatives, and processors and companies. FI will use technical assistance and project development, respectively, as its tools. A third group of participants, donors and banks, will be enlisted to bring a third tool, money, to the effort. The strategy will be to increase agricultural turnover by increasing both the supply of raw product and the demand for that product in a roughly balanced progression.

The short-term goal of FI technical assistance will be to create the conditions under which processors will operate in the Donji Lapac area so that farmers can receive a sustainable income for their production. To achieve this goal, it will be necessary to expand the current levels of production so that processors have a reason to expend their time, fuel, and resources in purchasing these farmers' products. FI will develop potential projects with several processors and companies that have expressed interest in expanding into the area. A longer term strategy will add higher value-added production within the agricultural Cooperative(s) themselves so that farmers begin, through their Cooperatives, to process their own production.

In order to succeed, a new model must be implemented that will bring all NGO and donor capabilities to bear, at one time and in a concerted manner, on the problems of this region. The model will combine FI assistance to associations and cooperatives to improve marketing, production and finance, while NGOs and donors direct their support to the association and cooperative level instead of on small-scale, disbursed donations to individuals. In this way, FI's technical assistance, and the services offered by the farmers, can be optimized for large scale production and thus reduce input costs, increase management productivity, and provide a unified marketing front for the farmers. The intended result is to maximize the farmers' production value, and that these organizations, managed by professionals, will concentrate on business issues on behalf of their members.

Short-term Actions

Most of the current farmers are engaged in subsistence farming and their products are consumed in their homes or are sold to neighbors. To change this and to develop the agricultural market, farmers will be assisted in the following ways:

1. FI will connect Donji Lapac farmers with the Croatian Agriculture Extension Service, other farmers organizations, processors and the County Department of Agriculture to facilitate information exchange and modern management. FI will provide technical assistance to the management of Cooperatives in the area and will assist in establishing an farm record-keeping system.
2. FI will coordinate with banks and donors and assist farmers with loan and grant applications to procure additional livestock. Funds are available from the Ministry of Agriculture as well as other sources for livestock purchases. Technical assistance in livestock feeding and husbandry will also be provided to farmers. The goal is to increase milk and meat production in the municipality.
3. FI will promote modern farm record keeping systems and will encourage all farmers to register as individual taxpayers within the VAT system. A certified accountant will provide instruction to agricultural organizations so that they comply with applicable tax and other regulations. FI has begun this process with seminars on accounting and tax compliance to provide farmers with information on how to best comply with Croatian law.
4. FI has already connected local farmers with the Croatian Livestock Selection Service to enroll livestock in the Selection Service, which this year entitles the farmers to government support and cash subsidies. The purpose of this subsidy program is to improve genetics among existing livestock. FI recommends that all NGO livestock donations be locally purchased and registered with the Selection Service.

Long-term Actions:

FI's long-term technical assistance will concentrate on:

1. Technical assistance to local agricultural Cooperatives that will provide value-added services and processing for the farmer members. New associations and cooperatives will also be formed, most likely containing members from several villages. Technical assistance will focus on introducing new technology, new products, and conducting marketing research on behalf of the farmers. Introducing new technology and methods of producing livestock feed for dairy cattle, such as haylage and silage, will increase the level of milk provided and move the municipality toward the feasibility of a cheese production facility.

2. Working with the farmers, FI will determine the most profitable products and optimal marketing strategy in the municipality of Donji Lapac.
3. FI will work to arrange for donations or loans for appropriate seed donations and equipment from donors, technical assistance from the Ministry of Agriculture and Forestry, as well as having a local Cooperative provide operators for the equipment.
4. FI will provide technical and organizational assistance, and attempt to locate equipment, so that haylage production can begin in the area. Haylage is a mixture of grass and clover harvested in the spring and fall which provides increased nutrition to cattle. Haylage is baled at a higher moisture content than dry hay and is stored in a sealed plastic wrap, minimizing the drying process in which nutrients are leached from the hay. Haylage is currently not produced in the area and FI will attempt to locate resources for such an enterprise, which will increase meat and milk production levels.
5. FI will promote organic certification and quality production, including an EU branding process (see below) and geographic certificate of origin services to increase the market value and quality of local production.

Cheese Production Facility

A strategic goal on the part of municipality officials, local farmers and the agricultural cooperative must be to increase the number of dairy cattle and thereby the local milk production base. The means toward realizing this goal is to develop a cheese production facility as a logical next step which will allow farmers to receive added value for their milk production. Such a facility, which would produce specialized traditional cheeses such as Lika, Basa, Skripovac and other local types, is correctly being heavily promoted by the municipality. However, there is not enough raw milk currently produced in the area to justify the investment and operating expenses of such a facility.

FI has recently completed a study outlining the requirements necessary for a cheese production facility to operate profitably in Eastern Lika. The study shows that a minimum amount of 2,000 additional liters of milk a day must be produced to cover the operating and amortization costs of such a facility. Currently, approximately 2,700 liters a day are produced in the municipality. Therefore, milk levels must be increased by approximately 80% for a cheese processing facility to be economically feasible.

There are an estimated 300 cattle in the Donji Lapac area, which is roughly 15% of the pre-war level. Currently, the level of milk produced in the municipality is just about sufficient to cover the consumption needs of the local population. Therefore, immediate efforts should be focused on increasing the number of dairy cows from 300 to approximately 550, which will produce the minimum amount of excess milk (that not consumed immediately by the local population) needed to profitably operate a cheese production facility in the area. FI will assist in this effort, providing assistance in animal husbandry and feeding to realize this goal.

As the level of dairy animals and milk production increases to a sufficient point, FI will assist the farmers in developing a cheese production facility to specialize in processing milk into an value-added form which commands a higher price and is easier and cheaper to transport. To facilitate this, the local municipality has committed to donating or leasing a vacant municipally-owned building to establish the processing company. FI will coordinate efforts to procure debt financing from a local bank to finance the equipment, and to solicit donations from international organizations to provide the material for building and operating the facility.

Organic Production

Donji Lapac is an unspoiled rural area which contains no sources of industrial pollution. It is well-served by the Una river, which provides mountain runoff water of exceptionally clean and pure quality for irrigation purposes. Additionally, none of the local farmers or municipal residents use artificial fertilizers or pesticides in their agricultural production, primarily as they cannot afford them due to low income and high transport costs. These circumstances make the area exceptionally well-suited to low-intensity organic farming.

There is currently a strong market in local produce. In addition, recent trends in Europe (BSE, green policies, etc.) have led to organically-produced and certified foods commanding higher prices as demand outstrips marginal supplies. Organic production, in combination with agro-tourism opportunities for the area, can result in Donji Lapac adding significant value to its basic agricultural production. The benefit of organic certification is that it offers immediate market distinction to a product and includes it in a web of distribution and marketing that encompasses all of Western Europe. As Croatia's WTO membership results in decreased tariffs on agricultural imports, local farmers should focus on quality and marketing to compete with European farmers.

FI recommends that local farmers take initial steps to begin the process of organic certification of their basic produce, and in general increase their focus on quality rather than on quantity. FI will develop a comprehensive study to assist local farmers with the expensive and time-consuming process of working with national and EU certification authorities. The goal of this process is to receive a certificate of quality which can potentially give access to higher-margin markets in Croatia and the EU. A detailed investigation must be conducted to determine the advantages of such a commitment, although any increased focus on quality and natural production will be a step in the right direction in terms of adding and increasing production value.

There are many reasons to implement such a strategy. The EU and its residents have in recent years increased the priority on organic farming for several reasons: human health and food security, conserving and protecting the environment, exploiting favourable climatic conditions, the preponderance of small farms, the availability of family labour, etc. Organic farming helps to maintain the environment as well as a good proportion of the population in rural areas; contributes to food security and supplies the local market, including the country's sizeable tourist industry, with good quality fresh produce. Croatia continues to earn an important amount of foreign currency through the tourism market, which accounts for over 10 percent of the overall agricultural consumption in Croatia.³ The main markets, initially, of agricultural products from the area are expected to be the hotel complexes in the Plitvice National Park as well as tourist consumers on the coast. Area farmers will be assisted by FI in targeting this market.

³ Source: <http://www.organic-europe.net>: Informationen zum ökologischen Landbau in Europa

5. Potential funding sources

Developing a specialized and focused fund-raising strategy, concentrating on local and national banks, reconstruction agencies and international organizations (EU, USAID, UNESCO, etc.) and potential investors is the key to realizing the financial means necessary to foster economic development efforts. Since it is currently impossible for Donji Lapac to support its reconstruction needs through tax revenues, a crucial part of its efforts must be focused in the direction of fund-raising activities. So far this issue has not been addressed in a systematic manner. FI recommends that all potential sources of reconstruction of economic development income be divided into three categories; donor funding, debt financing and direct investment, which are described in detail below:

A. Donor funding

Donors are organizations which grant money and/or fund reconstruction efforts for a “good cause” with limited or no corresponding demands or requests. They are usually international organizations and consider the size of a potential project and its impact in terms of realizing their goals (return of refugees, etc.) in their decision-making process. Therefore, all potential donors should be addressed in these terms – explaining the benefits of a project in relation to their goals, and emphasizing positive aspects of a project in terms of *marketing for the donor*

This category of donor funding also includes government grants and incentives developed by various ministries, particularly the Ministry of Agriculture and Ministry of Crafts. FI and the municipality will make every effort to procure government funding for competitive SME's, which usually contains low interest or a grant component. Similar programs have been funded in other areas of Croatia, using a combination of donor interest, bank loans and government grants to support sustainable SME projects.

Donji Lapac must more effectively target potential donors with a focused campaign to generate reconstruction and development funding. The approach must be considered from a marketing or "fund-raising" perspective. This initiative will begin with a donor forum which will be organized by FI to actively solicit new donor funding and interest in reconstruction efforts for the municipality. The forum, which will address the needs of 4-5 municipalities in the area, will be held in Plitvice and be titled "Infrastructure and Economic Development Forum for Eastern Lika." The following steps will be followed in implementing this task:

- International non-governmental organizations, multinational companies, large and successful Croatian corporations, influential individuals, etc., will be targeted. Invitations will be sent to all potential donors, including embassies, consulates and all major international organizations one month before the event.
- The next step, before the forum takes place, will be to research potential donors and their activities and provide them with a letter explaining the needs of the municipality and recommending specific projects in accordance with actual numbers and information. A goal will be set and a log kept of all efforts.
- The event itself will be announced through the media, to receive as much publicity as possible. A press conference will be scheduled after the forum. The conference attendees will be offered traditional food and drinks in a hospitable style, and at that time projects will be presented to specific donors which correspond to their overall goals.

B. Debt financing

Debt financing, which can apply both to a "development" bank such as HBOR as well as to "for profit" banks represents a valuable potential source of funding for SME's in the Donji Lapac area. However, a major problem for entrepreneurs seeking debt financing is that Croatian banks require high amounts of collateral for loan disbursement. This is a response to the inherent risk of making a loan under the current economic conditions in Croatia, particularly in the war-affected areas.

Efforts must be made to reduce risk, gain banker confidence and to present professional business plans to lending institutions. The following steps will assist in this process:

- The first step is to conduct a detailed survey of credit programs which are available to SME's at the local and national level. FI has completed this process and the survey is available to all interested parties. The length of the document (over 20 pages) precludes its attachment to this plan, but it is available at the Business Support Center and will be used to facilitate, to the highest degree possible, funding requests by SME's.
- A strong relationship with local and national banks, particularly in Zagreb, Split and Zadar, is required to provide a link between SMEs and sources of debt financing. Local banks should be targeted with a series of presentations of projects with the highest potential in the area. FI has begun this process, which will include providing due diligence and other services which will increase the likelihood of financing for client SME's.
- As SME's grow and new SME's or projects are developed, FI will monitor their needs and provide technical assistance to facilitate loan requests and/or prepare them for the next stage of development, most likely investor funding.

C. Investment

The likelihood of an SME in the Donji Lapac area receiving an investment by a profit-oriented investment firm is not high due to a perceived lack of competitive advantages and high levels of infrastructure destruction. However, in coordination with municipal and government officials, specific projects could be packaged into investment proposals which would be attractive for outside investment. Contacts must be increased with investment funds in Zagreb and FI will explore, alongside local economists and the new Development Center, what sources may be tapped.

The search for foreign partners, equity investors or other sources of capital to assist entrepreneurs and SME's in finding capital for expansion is necessary. For solid SME's with high potential for profitable operations, technical assistance must be provided to work with management to develop business plans and other documentation to attract investment. This will be conducted by FI through the Business Support Center.

Although significant reconstruction efforts must take place in an effort to improve the infrastructure and increase economic development, FI recommends that a study focusing on tourism and wood processing be developed with a focus on greenfield investment as well as donor or debt financing. These projects must be market-supported and based on the economic potential for profit. These activities, most likely operated under a concession from the local and national government, offer the best chances for a proposal which will interest investors.

6. Conclusion

This study presents a coherent economic development plan for Donji Lapac which can be used to focus efforts to increase the quality of life for the local community, protect the unique heritage of the area and develop an economic “engine of development” for Eastern Lika. By recommending a focus on key industries with an emphasis on low inputs and sustainability, the study provides important guidelines for future planning. Securing additional financial sources is vital for the area's development and is a key limiting factor in the process of economic recovery. It is vitally important that Donji Lapac has an agreed plan for economic development, particularly one which will not damage the natural environment and which will contribute to the process of return and reintegration. It is equally important that the plan be implemented.

The focus of economic development efforts in Donji Lapac and other municipalities should be on agricultural production and the SME sector, including agricultural cooperatives, services, and the processing industry. As has been proven in other areas of Croatia, unless there are viable economic opportunities for returnees, working age populations will not return in large numbers or remain in the area. The goals of these recommendations are to create sustainable employment opportunities by strengthening and expanding SMEs, and to establish strong farmer-owned agricultural cooperatives in the municipality which will provide value-added services and processing for farmers in order to increase the income from their production.

The recommendations are designed to be carried out with a high degree of municipal support and community participation. FI intends to provide technical and other assistance to the highest degree necessary to transform the municipality, and to develop employment and return opportunities for all current and former residents. The development of a local Business Support Center, a development center, a tourism board, and the search for local and international partners and organizations will add significantly to chances for success.

APPENDIX A - INFORMATION ABOUT THE MUNICIPALITY OF DONJI LAPAC

The Donji Lapac municipality is located in the eastern part of Ličko-Senjska county on the slopes of the Plješevica mountain range near the Croatian-Bosnian border, which lies 15 kilometers to the east. The municipality borders to the west with Korenica and Gračac and to the south with Knin. Donji Lapac itself is situated on the crossroads of two state roads: road 506 from Korenica and road 218 from Bihać (BiH). The position of the municipality is extremely remote, particularly as the border crossing toward Bihac is still not open for foot or vehicle traffic. The Unska railroad (recently opened for freight traffic) crosses the border at Uzljebić in the northern part of the municipality and follows the eastern border with Bosnia.

A. Pre-conflict situation

In 1991, the municipality consisted of the town of Donji Lapac and 32 surrounding villages. After the 1997 Law of the Territorial System of Croatia was passed, the municipality was divided into two new municipalities: the municipality of Donji Lapac with 17 villages and the municipality of Srb in the south with 15 villages. This division was made roughly through the geographic middle of the former municipality and the dividing line follows the southern borders of the villages of Brezovac and Doljani.

In 1991 there were 8,054 inhabitants in 2,603 households, consisting of 7,854 Serbs, 65 Yugoslavs, 44 Croats, 22 Muslims, and 69 “others” who were primarily ethnic Serb. Based on this most recent census the municipality had a population which was over 97% ethnic Serb. Additionally, Donji Lapac was one of the most underdeveloped regions in the former Yugoslavia, and several factories were founded and governed on non-sustainable socialistic principles based on providing full employment to the municipal residents.

Before the war there was one elementary school with six branch schools having a total of 390 pupils and 32 teachers. There was also one secondary school with 58 pupils and 17 teachers. There was a bank, a post office, a pension fund office, a health clinic (newly built) with 5 resident physicians. Because of the relative isolation respective toward the rest of Croatia, the Donji Lapac municipality was naturally inclined towards Bosnia, namely, toward the town of Bihać which was the economic and cultural destination for the region.

The municipality had a population density of about 9 persons per square kilometer.⁴ The area received substantial economic development assistance from the former Yugoslav government, which built large companies in the area to provide employment for local residents. The area was never competitive in crop production and the vast majority of households were primarily supported by non-farm income. However, similar to most rural areas in Croatia, many of the households supplemented this income with limited agricultural production.⁵ Typically, this consisted of a garden with small amounts of fruits and vegetables, orchards, pigs, cows, poultry, sheep and/or goats. These products were mainly produced for household consumption and small amounts were sold on the local fresh markets.

⁴ Croatia has an average population density of about 83 persons per one square kilometer.

⁵ Despite their small size, most of the farmers maintain a traditional mix of enterprises, including grain and livestock production. Some farms also produce vegetables, plums and other fruits.

In 1991, 1,654 residents were employed full-time in state owned or private enterprises, primarily, **DIP PLJEŠEVICA** (360 employed), **VISOČICA** (165), **KAMENSKO** (293), **LIKATRANS** (120), **P.P. LIKA** (90), **UNA** (172), **LIČANKA** (80), **ŠUMARIJA** (155), including 219 were employed in smaller socially owned enterprises.⁶ In addition, public sector employers such as the police department employed 315 residents, while 6,085 residents were homemakers or receiving unemployment or retirement pensions. The remaining households (less than 1 percent) were solely supported by farm income. Residents employed full time in socially owned enterprises and the public sector derived their primary income from salaries, while supplementing their income with small-scale agricultural production for sale on local markets.

B. Current situation

Today, the municipality consists of the town of Donji Lapac and 17 surrounding villages: Birovača, Brezovac, Dobroselski, Bušević, Dnopolje, Dobroselo, Doljani, Donji Štrbci, Gajine, Gornji Lapac, Gornji Štrbci, Kestenovac, Kruga, Melinovac, Mišljenovac, Nebljusi, and Oraovac. According to the Croatian Law of Counties, Municipalities and Towns of 1996, the pre-war municipality of Donji Lapac was divided into the above villages, while the remaining villages were allocated to the Srb (Gracac) municipality in the south.

The area is not mined except for the northern part of boarder towards Bosnia. Much of the infrastructure of the town is in need of development. The water-supply network (Donji Lapac receives most of its water supply from Kulen Vakuf in Bosnia) needs renewal over 50 kilometers of its length. The entire length of the municipal water-supply network is approximately 150 kilometers. The sewage system is also in poor condition and needs extensive renewal. Additionally, approximately 150 kilometers of road needs to be paved and of 185 kilometers of transmission lines in the municipality, over 80% needs repair. Telephone lines for the most part exist only in the downtown area and the immediate vicinity (about 300 total numbers). The total amount of municipal budget for the year 2001 was 3.2 million kuna.

According to municipal officials there are approximately 3,850 inhabitants currently resident in the municipality. The approximate number of those employed is 140, out of which 65 work in the police and border control while the rest in municipal government, forestry department, schools and post office. There are approximately 25 individuals working in full time productive employment in the private sector (construction, carpentry and other crafts, etc.). Officially, there are 364 unemployed in the Donji Lapac municipality, over 400 people are receiving pensions while 60 residents receive welfare. The unofficial, i.e. actual number of unemployed is much higher, approaching 70% of the population.

NOTE: The population count is an estimate and varies on the ground due to the transient nature of a portion of the population which shuttles between Donji Lapac and the RS or Yugoslavia. Before the war, ethnic Serbs made up 97% of the total number of the inhabitants in the municipality, while today the percentage of the Serb population is approximately 75-80%.

⁶ These enterprises were considered “socially owned” (owned and managed by the employees). The system of socialist self-management remained a distinctive element of the Yugoslav economy up to 1991.

Municipality leadership

The municipality is led by the Municipal Council (Općinsko Vijeće) which was formed in 1999 and consists of 10 SDS representatives, 2 HSP representatives and 2 from the SRP. The most recent election was held in August 2000. The Mayor of the municipality is Milan Đukić, while the chief of the Economic Office is Dragomir Đević.

Municipal Assets

Despite the war, most SME's in Donji Lapac functioned normally during the period of Serb occupation in 1991-1995. The town itself and most of the villages were not damaged as the area was not close to the front-line. After Operation Storm, the town was deserted by the Serb population and over the next year the town and the most of the area was destroyed, burned and looted. As a result, over 70% of housing capacity of the municipality was damaged and most of the machines, equipment and stock from the local companies and stores was stolen. Additionally, most of the municipal land books and official documentation of any kind were destroyed as well, there is therefore little written evidence of municipal asset ownership.

According to informal sources in Donji Lapac, property owned by the municipality and/or the Croatian Government in Donji Lapac includes a municipal hall, various shops and crafts in the town, cemeteries, conflicting amounts of arable and non-arable land, as well as all roads, creeks, and public buildings.

Agricultural Production

Most of the households in the surrounding villages are engaged in small-scale, mixed agricultural production in combination with pension payments or donations from NGO's and/or from family members located outside of Croatia. Agricultural production is very basic and consists primarily of raising livestock, small crops of fruit and vegetables, and limited grain crops. The number of livestock has decreased to 80% of pre-war levels.

In 1991, there were two agricultural co-operatives in the villages of DOLJANI and KESTENOVAC. They were engaged in small-scale trade and cattle buy-off. There were a total of eight people employed in both of them. Today, the facilities are devastated and the municipality is attempting to dispose of them. Currently, the Lika Agricultural Cooperative is the nucleus of local farmer efforts to add value to their production and will coordinate with FI and other outside parties for its further development.

Current agricultural production is roughly 20% of the above level and is concentrated in hay and other feed for livestock. With the elimination of the Bihac area as a source for buy-off of crop products, most production serves the purpose of home consumption or fattening cattle for meat consumption.

Cultivated surfaces (current)

- privately owned	8,550 ha
- state owned - unused	10,146 ha
TOTAL	18,696 ha

Total number of livestock according to municipal veterinary station (year 2001)

	1990	2001
Cattle	1,570	280
Pigs	890	450
Horses	305	4
Sheep	2,840	1,659
Goats	1,120	135

Livestock numbers by village (where available):

SETTLEMENT	Number of livestock owners	Cows	Sheep	goats
BIROVAČA	12	9	138	
DNOPOLJE	14	29	38	2
DOBROSELO	19	43	366	11
DOLJANI	12	19	165	8
DONJI LAPAC	38	28	435	32
GORNJI LAPAC	13	19	122	
KESTENOVAC	7	8	78	
KRUGE	16	19	71	7
NEBLJUSI	27	39	118	
ORAOVAC	34	45	158	58
TOTAL	192	258	1689	119

Crop, fruit and grape yields, 1991 :

In tons

	Wheat	Maize	Potatoes	Hay	Apples	Plums	Grapes
Agricultural companies and cooperatives	-	-	70	-	-	-	-
Private producers	872	2,524	1,491	3,484	-	-	-
Total	872	2,524	1,561	3,668	-	-	-

APPENDIX B – SUBMISSION LETTER FOR TZ FORMATION

Mrs. Andreja Pešutić
Manager of the Branch Office Responsible
for Tourist Boards
Ministry for Tourism - Republic of Croatia
Ulica grada Vukovara 78
10000 Zagreb

Municipality of Donji Lapac
Trg Boričevac 1
53250 Donji Lapac

SUBJECT: Request for foundation of a tourist board in Donji Lapac

Dear Ms. Pešutić,

With the goal of changing the difficult economic situation and making an improvement in the state of living conditions on the territory of our municipality, we have concluded that developing tourism activities, in particular ecological, hunting and agro-tourism, may change the situation for the better.

Our Municipality, in cooperation with the American consulting organization FI International and the Swiss government, has initiated this idea. At the same time, FI is offering its significant support in preparing, organizing and planning our project.

The basic condition for the realization of the above-mentioned idea is the foundation of a Tourist Board in our municipality. For this reason, we officially request your support in forming such a Board and would like you to inform us about the measures which must be taken to proceed further.

We hope that you will support our project and help us to realize it success, which will have a substantial economic impact on the local population.

Sincerely
Municipality Donji Lapac
Office of the Mayor
Milan Djukic

APPENDIX C - SOURCES OF INFORMATION

Agricultural Cooperative Lika
Arbeiter-Samariter Bund (ASB) Knin
ARC
Croatian Ministry for Public Works and Reconstruction
Croatian Ministry of Tourism
Croatian Ministry of Agriculture
County Agriculture Department
Croatian National Tourist Board
CARE Knin
CRS Knin
Dairy Production and Trade Developments, FASonline
FI Agricultural Advisors
ICMC Knin
IRC Knin
Lika County Chamber of Commerce
Lika County Tax Office
Lika County Institute for Statistics
Lika County Employment Office
OSCE Knin
Interviews with residents
Interviews with Agricultural Extension Service personnel
Interviews with local cheese producers
Interviews with cheese producers Tomaic Commerce and I-Pak Dairy
Municipal officials
Municipal Land Office
SEAF
State Institute for Statistics
Swiss Federal Statistical Office, Neufchatel
UNDP Zagreb
UNHCR Knin
United States Department of Agriculture
UNOPS Sibenik
Zadruzni Savez of Croatia